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In Practice

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Excalibur Ventures v Texas Keystone: what litigation funders need to know

In a decision which has major ramifications for the litigation funding market in the UK and overseas, the English Commercial Court ruled on 23 October 2014 that the third parties who had funded the unsuccessful litigation brought by the brass-plate Delaware corporation, Excalibur Ventures LLC, should be jointly and severally liable to pay the defendants' costs of the action on an indemnity basis. The authors represented one of the defendants, Texas Keystone Inc, both in the underlying US$1.6+bn litigation initiated by Excalibur in which all claims against the defendants were dismissed following a 57-day trial and in the ensuing costs litigation against Excalibur's funders. In this article we explore some of the key points arising from the court's judgment on costs and identify issues for funders to consider.

Following Excalibur's complete failure at trial the court ordered that the defendants' costs of the proceedings were to be assessed on the indemnity scale – which typically allows for recovery of around 85% of a party's incurred costs rather than the standard 65-70%. The court gave a multitude of reasons for that award, including the "speculative and opportunistic" nature of Excalibur's claims, which in a stinging rebuke for its lawyers were described as "objectively hopeless" as well as "bad, artificial and misconceived". The unacceptable conduct of Excalibur, its witnesses, its key expert and its lawyers were further key reasons. Given Excalibur's parlous financial state it was not going to be able to meet the shortfall due in respect of its costs liability and so the defendants successfully applied to join Excalibur's funders to the proceedings for the purpose of seeking a costs order against them.

Following a three-day hearing in June 2014, the court found against each of Excalibur's funders and ordered that they be made jointly and severally liable with Excalibur to pay the defendants' costs of the action on the indemnity basis. The funders – (1) Psari Holdings Limited, a Cayman Island fund wholly owned by Mr. Andonis Lemos; (2) Blackrobe AEO Investors I, LLC, part of the now defunct Blackrobe Capital Partners funding group; and (3) various entities in the Platinum group of companies – had already paid out in excess of £31m (US$50m) to fund Excalibur's claims and now face further financial exposure, well in excess of that envisaged when they decided to support the litigation.

ISSUES FOR THIRD-PARTY FUNDERS

Third-party funders need to consider the following issues when deciding whether to fund litigation and how to manage their exposure.

(1) In light of the judgment it is clear that third party funders can be made jointly and severally liable for an indemnity costs award visited on the party they elect to fund regardless of a lack of bad conduct on the funders' part. While Excalibur's funders were not directly responsible for some of the behaviour which led to the indemnity order, Clarke LJ found that "the conduct of the funders in promoting this legation with all its ills" made it just to award indemnity costs against them as well. While indemnity costs awards remain relatively rare (where litigation or the conduct of it is "outside of the norm"), funders should ensure that they take steps to actively scrutinise the merits of a claim and the credibility of those involved in presenting that claim (ie witnesses and experts) through independent due diligence. The Judge found that the funders should have appreciated that the litigation was speculative and opportunistic (a stand-alone ground for an indemnity award) in that they were provided with certain documents by Excalibur ahead of deciding to fund which ought to have opened their eyes to critical weaknesses in Excalibur's case. The judge found that the funders' poor due diligence lead to the pursuit by Excalibur of an "objectively hopeless" claim; the clear implication being that a proper review ought to have meant that the claim was never funded.

(2) All that being said, even if funders did receive strong (but ultimately erroneous) legal advice on the merits of a claim ahead of making the decision to provide funding, that may still not provide absolute protection. Particularly so where a claim is found to be as inherently flawed as Excalibur's. Funders must take their own view on the merits of litigation with or without independent advice. What is clear from the *Excalibur* judgment is that if funders may ultimately want to rely on the fact that they took independent legal advice to support an argument that their own behaviour cannot be called into question should they be accused of deliberately pursuing opportunistic litigation, then they should ensure that they do so on more than just a nominal basis. The firm they instruct should be independent and be able to form a sufficient understanding of the case and those involved in making it out to perform a worthwhile assessment. In the *Excalibur* case, the court noted that one funder relied exclusively on the assessment of the merits provided by Excalibur's own lawyers, who were hardly objective given that they had already agreed to take the case on a partial contingency. The legal opinions provided to Excalibur's other funders by independent firms also relied substantially on the advice given by Excalibur's lawyers, which was in large part assumed to be accurate. In other words the advice was replete with caveats and assumptions. The case is therefore a good illustration of how there can be a tendency to endorse opinions given by other firms who have already looked at the matter previously (especially if those firms enjoy a certain reputation in the market and/or there are costs constraints) rather than the new firm performing a truly independent review. In other words there can be a "follow the herd" mentality.

Likewise funders may be satisfied with what appears to be an independent endorsement of the claims even though the in-built assumptions and caveats make it far from being one. What is clear from the *Excalibur* case is that it is advisable for funders to ensure that the legal advice they seek is rigorously considered and not reliant upon assumptions

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derived from the potentially faulty assessment made by the claimant's own lawyers. Given the court's assessment of Excalibur's claims as "objectively hopeless" that may still not have saved Excalibur's funders here but it would provide a distinguishing feature to this ruling, and, at worst, place a funder in a better position to take issue with its own lawyers' faulty assessment than if those lawyers were, on instruction, simply working from faulty assumptions discerned from the advice of others.

(3) The court was also particularly scathing of one of the funders for failing to get a second opinion on the merits despite having "uncertainties and doubts" ahead of a request from Excalibur for additional funds. This clearly demonstrates that whenever further funding is provided, the court will expect a re-assessment of the merits of the claims at that stage rather than reliance being placed on some historic assessment made many months or years ago. Litigation can be a lengthy war with many battles won and lost along the way. Claims can improve or become untenable as further evidence is served meaning that re-assessments need to be made frequently and in real time. Especially so from a funder's perspective if further funds are to be contributed part way through the litigation rather than just at the outset. Proper diligence should be brought to bear with each fresh injection of capital.

(4) In addition to pure merits, the funders knew that part of the strategy to be deployed by the claimant was to accuse one of the defendants' key witnesses of fraud and of giving false evidence. As the individual concerned was the CEO of a publicly traded company it was felt that this would drive him/the company to the negotiating table. As it transpired it did not and the fraud claim was roundly rejected and criticised by the court. Having knowingly funded a claim which featured that risky and dubious legal strategy the judge felt that the funders should bear the same risks of the strategy failing as the party they funded. What this makes clear is that if the funders are brought into the know on litigation strategy then they will bear the consequences if they endorse it through funding. This means that there is a delicate line to walk. On the one hand funders must still be careful not to offend the rules of champerty and maintenance by controlling the conduct of litigation, but on the other hand if they are aware of aspects of how the litigation is to be conducted and fund it regardless then they will bear the consequences.

(5) Parent companies of funding parties can be found liable for adverse costs despite funding a claimant indirectly. The court will look at the economic realities and, in the *Excalibur* case looked to the entities that, in reality, made the investments in the litigation, by putting their subsidiaries in funds, and stood ultimately to share in the proceeds had the claim prevailed. While funnelling funds to SPVs or subsidiaries which then ultimately lend to the litigant might offer some protection to funders vis. their contractual relationship with the funded party, funders cannot consider themselves protected from adverse costs by setting up complex group structures aimed at shielding the ultimate parent or funder from liability. The court in *Excalibur* expected the parent funds to "stand in this case together" with their subsidiaries. In the *Excalibur* case the court was prepared to make a costs award against one parent fund, Platinum Partners Credit Opportunities Fund LP, despite it failing to acknowledge service of the defendants' applications or participate in the proceedings at all. It did so because of the economic realities whereby the funds were originally sourced from that parent fund and simply channelled to the claimant through subsidiaries. Likewise it was the parent fund that would have been the ultimate beneficiary of any windfall from the litigation. This should act as a warning to international funders who fund litigation in the English courts that, in addition to the potential reputational damage of trying to back away from your liabilities by opting not to submit to the court which has jurisdiction over the case you were funding, this may not, in any event, save you as the parent of a funder, or as the ultimate source of the funds, from an adverse costs award.

(6) The Arkin cap, which caps a funder's exposure for the costs of the other side to the extent of his financial contribution to the party he is funding, should be measured by reference both to amounts contributed to fund a claimant in respect of its costs and the amount contributed solely to enable that claimant to pay security for the defendants' costs. No distinction should be drawn between the two.

(7) For funders already committed to funding a claim, the point at (6) above adds a further level of practical difficulty in cases where a defendant applies for security for costs. While the potential for an order for security to be paid into court for a defendant's costs ought to be on a funder's radar at the outset (where the funded party is impecunious and not domiciled in the EU) funders may face the potentially difficult decision between: (i) choosing to make further significant funds available to a claimant early on in the litigation so that it can pay security and continue its claim; (ii) suffer a dilution of interest as other funders will be required to pay the security; or (iii) risk the claim being abandoned. In addition, it is now clear that funders will be expected to independently re-evaluate the merits of the claim at the point at which additional funds are required (see (3) above). There is also no saving grace for those who just fund security given that following the decision here funders of security do not escape accountability for adverse costs (up to the amount paid in security).

(8) Litigation funders should actively consider hedging options such as insurance for adverse costs as a means of managing the risks of funding litigation. In *Excalibur* certain funders were insured for adverse costs, while others were uninsured. In a post-*Excalibur* world, managing the additional risk of: (a) an indemnity costs award; (b) a joint and several liability ruling which clashes with the terms of the inter funder agreements; and (c) a co-funder bankruptcy will be important, whether through insurance, indemnity agreements with those with conduct of the litigation or more detailed inter-funder agreements. Having agreements in place with the funded party alone may offer limited protection if it has no assets.

CONCLUSION

Excalibur should act as a cautionary tale for those considering funding expensive litigation. While the potential upside for Excalibur's funders was immense, their final exposure will be similarly immense. The judgment will clearly not mean the death-knell of litigation funding; Clarke LJ noted that he did not intend to "send an unacceptable chill through the litigation funding industry". Instead, he considered that if his judgment causes funders/their advisers to take more rigorous steps to ensure they are funding good claims, then that is "an advantage and in the public interest". ■